

**A LEVEL**

**Examiners' report**

# **ECONOMICS**

**H460**

For first teaching in 2019

**H460/01 Summer 2023 series**

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## Introduction

Our examiners' reports are produced to offer constructive feedback on candidates' performance in the examinations. They provide useful guidance for future candidates.

The reports will include a general commentary on candidates' performance, identify technical aspects examined in the questions and highlight good performance and where performance could be improved. A selection of candidate answers are also provided. The reports will also explain aspects which caused difficulty and why the difficulties arose, whether through a lack of knowledge, poor examination technique, or any other identifiable and explainable reason.

Where overall performance on a question/question part was considered good, with no particular areas to highlight, these questions have not been included in the report.

A full copy of the question paper and the mark scheme can be downloaded from OCR.

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## Paper 1 series overview

The paper discriminated well across the three Sections. Candidates who were able to deploy their knowledge and understanding of the specification content were rewarded highly. There was some excellent understanding of labour market issues in Section A and some technically proficient responses to questions requiring extended writing in Sections B and C. Diagrams in Section B were well known and more successful candidates were able to incorporate them into their analysis and evaluation. Chains of reasoning were evident in the best responses, for example explaining how indirect taxes of tobacco impacted on production costs rather than simply asserting that the supply of tobacco products would shift to the left. The distinction between demerit goods and goods with negative externalities continues to be an issue, with the terms used interchangeably and without attention to the meaning of the concepts. The explanation of market failure in the case of the provision of public goods is an area of weakness. Contextual analysis was evident in many responses, with candidates making good use of the stimulus material in Section A and the question stems in Sections B and C. The key discriminator in questions requiring extended writing continues to be the extent and quality of the chains of reasoning offered by candidates.

Detailed feedback on the performance of individual questions is provided below.

Candidates who did well on this paper generally:	Candidates who did less well on this paper generally:
<ul style="list-style-type: none"> <li>• had a good understanding of the specification content,</li> <li>• focused clearly on the requirements of the questions set,</li> <li>• used accurate diagrams which were integrated into their analysis in Section B,</li> <li>• developed their points using chains of reasoning clearly showing cause and consequence,</li> <li>• set their responses in the context of the stimulus material in Section A and in the question stems in Sections B and C,</li> <li>• provided developed counter-arguments as part of their evaluation,</li> <li>• made and supported judgements at the end of their responses where required.</li> </ul>	<ul style="list-style-type: none"> <li>• showed imprecise knowledge and understanding of the specification content,</li> <li>• produced generic responses which did not fully focus on the requirement of the questions set,</li> <li>• produced inaccurate diagrams and / or did not explain diagrams offered in the body of their response,</li> <li>• tended to assert rather than explain using chains of reasoning,</li> <li>• ignored the context provided by the stimulus material in Section A and the question stems in Sections B and C,</li> <li>• produced summative conclusion which simply repeated what had been said in the body of the response.</li> </ul>

## Section A overview

The focus in Section A in this series was on aspects of labour market. Knowledge and understanding of wage differentials and trade unions was generally good. The concept of a remuneration gap, explained in the stimulus material, was less familiar to candidates and responses to Questions 1a(ii) and 1d were less convincing than responses to the other questions. The description of the relationship between the two sets of data in Question 1a(i) lacked reference to the rates of change over the period 2010 – 2019. It is worth reiterating that responses rooted in the application of economic terms and concepts enables candidates to achieve the higher marks / levels indicated in the mark scheme.

### Question 1 (a) (i)

1 (a) Refer to Fig. 2.

- (i) Describe the relationship between Chief Executive remuneration and stock market performance between 2010 and 2019.

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.....

.....

..... [2]

Most candidates recognised that there was a positive relationship between Chief Executive remuneration and stock market performance over the whole period. Full marks were available where candidates compared the rates of change of the two, rather than absolute changes.

### Question 1 (a) (ii)

- (ii) Explain why this relationship may exist.

.....

.....

.....

..... [2]

Many candidates found it difficult to explain why the relationship existed. Those that did were able to identify that part of the remuneration for Chief Executives comprised share options and that, therefore, their total remuneration would rise with improved stock market performance.

### Question 1 (b)

(b) A marginal income tax rate is one example of the marginal principle used by economists.

Explain what is meant by the economic concept of 'the margin'.

.....

.....

.....

..... [2]

The concept of the margin was understood and candidates were able to explain it using its application in many parts of the specification. For example, some referred to marginal rates of income tax, while others referred to marginal utility, marginal benefit or marginal cost.

### Question 1 (c)

(c) Explain, using an appropriate diagram, the size of economic rent relative to transfer earnings for essential workers such as cleaners. **Lines 23–25.**

.....

.....

.....

..... [4]

This question discriminated effectively. Accurately labelled labour market diagrams showing the correct area of economic rent were given two of the four marks available for the question. Reference to the wage elasticity of supply for essential workers and the relative size of economic rent were required for the other two marks.

## Question 1 (d)

- (d) A number of policies have been suggested to affect Chief Executive remuneration including 'Allowing greater use of 'say on pay' which allows a firm's shareholders to vote on Chief Executive remuneration,' **Lines 16–17**.

Evaluate, using evidence from the stimulus material, the extent to which greater use of 'say on pay' alone may help reduce the remuneration gap between Chief Executive and employee in the US.

**[8]**

Candidates did not always score highly on this question because they did not employ the toolkit of economic concepts and theories to analyse why 'say on pay' might reduce the remuneration gap. Much of the analysis offered by candidates was quite general. Some suggested that shareholders might vote to reduce or limit Chief Executive remuneration to maximise profits. Very few identified shareholders as the 'principal' and Chief Executives as 'agents' and, therefore, explained the relevance of the principal-agent problem in this context as in Exemplar 1 below. Those who did were given marks for strong analysis.

## Exemplar 1

Greater use of say on pay <sup>alone</sup> ~~will~~ <sup>^</sup> would help to reduce the remuneration gap between chief executive and employee in the US. This is because the shareholders of a firm are likely going to want to profit maximise whereas the chief executives ~~will~~ may have different objectives for example growth. ~~This~~ This means this is an example of the principal-agent problem as the principals (shareholders) have different objectives to the agents (chief executives). If there is a greater use of say on pay shareholders will have more control over chief executives and they will ~~likely~~ <sup>likely</sup> ~~decrease~~ <sup>reduce</sup> the remuneration gap to increase their own profit. Therefore <sup>say</sup> ~~pay~~ on pay <sup>alone</sup> will lead to the reduction of the remuneration gap.



This is a good example of a response to the question which effectively deployed the economists' toolkit of terms, concepts and theories.

The candidate clearly identifies the objectives of shareholders and Chief Executives. They then interpret the issue as a principal-agent problem. Finally, they conclude, by relating back to the question in terms of how 'say on pay' will reduce the remuneration gap.

This part of the candidate's response was given marks for strong analysis.

In comparison, evaluation was often stronger with many candidates making effective use of the stimulus material which suggested other ways in which the remuneration gap might be reduced. Some chose to explain reasons why 'say on pay' might not work and built effective evaluation around issues related to performance-related pay of Chief Executives and the inclusion of share options in the remuneration of Chief Executives. Invariably, final paragraphs tended to summarise rather than make and support a judgement.

### Assessment for learning



Candidates find making and supporting a judgement challenging under examination conditions.

Centres are advised to provide opportunities in the delivery of the content of the specification for candidates to practice making judgements.

Useful starting points for judgements might include the following prompts:

- what does the balance of arguments depend on?
- what might change the balance of arguments in favour of one side or the other?
- how might the balance of arguments change over time?
- what might change to affect the balance of arguments?
- how might the advantages / disadvantages be made more significant?

**Question 1 (e)\***

**(e)\*** Evaluate, using evidence from the stimulus material, whether weaker trade unions is the main reason for increased wage differentials in the USA. **[12]**

Although not required by the question, there were many examples of the effective use of diagrams by stronger candidates to support the argument that weaker trade unions are likely to be in part responsible for increased wage differentials in the US. This was very encouraging and showed candidates were willing to apply their knowledge and understanding to the question. Some chose to argue that strong trade unions can raise wages above the equilibrium, while others chose to argue that weak trade unions would not be able to bargain effectively against strong employers who would seek to push wages below the equilibrium. Both approaches were effective in providing evidence of well-considered analysis of the impact of weak trade unions on wage differentials. Candidates who recognised other causes of increased wage differentials in the US were able to provide relevant evaluation. This evaluation was good when it was supported using economic concepts. For example, some argued that wage differentials reflected differences in the demand and supply of labour in different occupations or provided developed chains of reasoning about the weakening of minimum wage protection for those in low paid jobs.

## Section B overview

This section of the paper requires candidates to use a diagram as part of their response. It is more usual for candidates to use a diagram in support of their analysis. To be placed in Level 3, the diagram offered must be predominantly correct and integrated into the candidate's analysis. Minor errors in the diagram will be ignored by examiners, but errors which impact on the validity of the analysis are likely to mean that responses are placed in Level 2 at best. In Question 2, therefore, it was expected that diagrams would support analysis of the harm to consumers of both collusion and monopoly. In Question 3, diagrams were expected to support the argument that methods of intervention would reduce the negative externalities of smoking. The specification is clear that candidates should be aware of the difference between negative consumption externalities and negative production externalities. The mark scheme reflected this, in that strong analysis required recognition that the negative externalities of smoking arise from consumption and not production. Responses to Question 3 also raised some misconception related to the nature of demerit goods which centres are advised to focus on in their delivery of the specification.

### Question 2\*

**2\*** In 2020, the Competition and Markets Authority (CMA) found that three pharmaceutical companies had taken part in an illegal agreement resulting in the price of a life-saving medicine supplied to the NHS increasing by up to 1800%. This was one of many examples investigated by the CMA where consumers were being disadvantaged by collusion and the actions of monopolies.

Evaluate, using an appropriate diagram(s), whether collusion and monopoly would always disadvantage consumers.

[25]

The requirement in the question to consider the impact of both collusion and monopoly was one that candidates responded to in a variety of ways. Some chose to argue, correctly, that collusion would have a similar impact on consumers of monopoly and analysed the impact using a standard monopoly diagram. Others considered collusion and monopoly separately. Either approach was acceptable. Less successful candidates chose to ignore one of the two requirements of the question, often collusion, and provided only a partial analysis therefore. Examiners commented that there was evidence of many pre-rehearsed responses with insufficient focus on the question. For example, excellent knowledge and understanding of the different types of inefficiencies of monopoly were very well explained but then not related back to the impact on consumers. A simpler approach which focused on price and consumer surplus was often much more successful. Evaluation focused on the potential use of abnormal profit by monopolists and by firms in a collusive oligopoly. The context provided an opportunity for candidates to talk about the case of R&D in the pharmaceutical industry, which more successful candidates did to good effect. Some candidates showed excellent knowledge and understanding of economic theory but provided little or no context throughout their response. Summative conclusions remain the norm, with few candidates taking a step back to offer a supported judgement on the question. For example, it would have been possible to argue that collusion is more damaging to the consumer than monopoly, which is why collusive agreements are illegal whereas monopolies are only investigated where there is a suspicion of the abuse of market power.

## Exemplar 2

On balance, <sup>the</sup> effect of collusion and monopolies on consumers will depend on the degree of contestability. As this may vary prices lower, closer to what prices which would not harm consumers as a consequence. Tacit collusion where firms engage in price leadership may also be more harmful than overt as it is more difficult to detect. ~~Overall~~ ~~to~~ ~~the~~ ~~strength~~ ~~of~~ ~~the~~ ~~regulation~~ ~~and~~ ~~strength~~ ~~has~~ ~~an~~ ~~impact~~ ~~on~~ ~~how~~ ~~consumers~~ ~~would~~ ~~be~~ ~~affected~~ ~~by~~ ~~the~~ ~~presence~~ ~~of~~ ~~oligopoly~~ ~~/~~ ~~monopoly~~

⊛ Monopolies and cartels will likely abuse their market power, exploiting consumers with higher prices, but...

This response has an effective, supported judgement relevant to the question.

The candidate has chosen to use the 'it depends' approach. They have identified that the extent of the harm to consumers of collusion and monopoly depends on the degree of contestability. This is then supported with good reasoning on the impact of contestability and on the nature of collusion. This is not a summary because these points have not been raised in the body of the response.

### Question 3\*

- 3\* A report for the charity Action on Smoking and Health (ASH) in January 2022 estimated that smoking in England imposed costs on the NHS totalling £2.4 billion and costs on businesses, from lost productivity, of £17.2 billion.

Evaluate, using an appropriate diagram(s), the most effective method of government intervention to reduce the negative externalities from smoking in England. [25]

The stem and question provided a familiar context in which candidates could apply their knowledge and understanding of negative externalities and methods of government intervention. As in previous sessions, there was confusion over the difference between demerit goods and goods with negative externalities. Many candidates used the terms indiscriminately which detracted from the overall quality of their response. That said, more successful candidates were able to analyse the market failure arising from smoking and identify that government intervention was required which reduced consumption. It was not necessary for candidates to cover more than two methods of intervention, but there did need to be a comparison of different approaches to sustain a judgement about which one was best and why. Less successful candidates were not able to meet this requirement of the question as they sometimes only covered one method of intervention. The best responses blended the analysis of market failure caused by negative externalities with the solutions – so, for example, showing how (and why) a tax shifted the MPC curve to the left so that the social optimum could be reached or showing how information provision / education might shift the MPB curve to the left towards the MSB. The strongest responses showed good knowledge and understanding of the benefits of hypothecating taxes and the distinction between limiting the consumption of smokers and preventing future externalities. Effective judgements did not have to be sophisticated, but did have to be supported.

#### Misconception



Demerit goods are different from goods with negative externalities.

Demerit goods are those where there is information failure – the consumer is not aware of the negative impact **on their own welfare** of consuming the good.

Negative externalities arise when the production or consumption of goods imposes a negative spill over effect **on third parties** not involved in the consumption or production of the goods.

## Exemplar 3

Personally I believe tax is the most  
 efficient <sup>method</sup> ~~general~~ of government intervention  
 this is because the government can  
 spend the tax revenue it gains <sup>on</sup> ~~from~~  
 trying to ~~make~~ <sup>help</sup> the NHS or find  
 ways to increase the productivity of  
 the economy to reduce the £17.2 billion  
 (loss) of productivity

This response is a good example of an effective judgement.

Previously in their response the candidate has analysed the advantages of a tax in terms of reducing the consumption of cigarettes and a reduction of negative externalities of smoking.

Instead of summarising what had been said before, here the candidate refers to the use of the tax revenue as a justification of why taxation of tobacco might be a better method of intervention than the other(s) considered in the main body of the response. This is, therefore, a judgement on the best method which is supported with a reason.

## Section C overview

Questions in this section of the paper do not require use of a diagram, in contrast to Section B of the examination. However, relevant diagrams integrated into the response can enable candidates to develop chains of reasoning and will always be given credit as part of the analysis or evaluation offered. In both questions, the key to a strong response was an accurate understanding of the concept referenced in the question and / or the stem to the question. Less successful responses to Question 4, for example, did not focus on the characteristics of public goods. Similarly, responses to Question 5 did not understand economies of scale as reductions in long run average cost and/or did not focus on their importance for a large retailer such as Aldi. Strong analysis in Section C requires developed chains of reasoning as does good evaluation. Candidates are advised to develop fewer points in greater detail rather than make more undeveloped points. Contextual analysis and evaluation can be considered part of these chains of reasoning. Summative conclusions do not hit the mark where examiners are looking for supported judgements related to the question.

### Question 4\*

**4\*** Flood defences are considered by economists to be public goods. The £67.4 million Ipswich tidal flood barrier is just one of the many flood defence schemes which has been completed during the government's current capital investment programme. The scheme protects 1600 homes and 400 businesses from tidal flooding.

Evaluate the case for government provision of goods and services such as the Ipswich flood defence scheme.

**[25]**

Weaker responses to this question largely ignored the direction in the stem, that flood defences are considered to be public goods, and wrote at length about perceived positive externalities of flood defences. These responses missed the point of the question. Better responses recognised the key characteristics of public goods, but only the best were able to explain how these characteristics justified government provision. It was expected that candidates would analyse how non-excludability in particular, would give rise to the free rider problem so that private sector provision would not be profitable and that there would be a missing market. Very few candidates analysed the implications of the final characteristic of public goods listed in the specification, namely zero marginal cost of supply. Those that did were able to construct a strong and convincing analysis of the case for government provision at zero price. Evaluation tended to be stronger, as most candidates were able to discuss issues related to opportunity cost and the inefficiencies of government provision. Better candidates questioned whether the characteristics of public goods necessarily had to involve government provision, with pleasing reference to the role of public-private partnerships. Particularly noteworthy were the very few responses which raised the idea that a sense of community and responsibility could lead local residents to jointly-fund flood defence projects such as the one mentioned in the stem to the question.

## Question 5\*

- 5\* Aldi, a discount supermarket, entered the UK market for the first time in 1990. Since then it has expanded its operation and, in 2022, its market share was 9.3% making it the fourth largest supermarket in the UK.

Evaluate the importance of economies of scale to a large retailer when deciding whether to increase the size of its firm.

[25]

Less successful candidates did not have an accurate understanding of economies of scale which meant that they were not able to make much headway with this question. Those who did understand the distinction between total and average cost did not always address the question set. For example, some described a range of different types of economies of scale without saying why these were important for a large retailer deciding whether to increase the scale of operation. The key link to good and strong analysis was to explain how lower unit costs would allow a large retailer to compete more effectively in a market dominated by a small number of large firms. Strong responses did so by recognising that the price elasticity of demand in grocery retailing is likely to be elastic and that firms such as Aldi will face a high degree of price competition. The ability to reduce unit costs through expansion of the scale of operation would enhance the price competitiveness of a large retailer such as Aldi therefore. Stronger responses also included good contextual understanding beyond 'bulk-buying'. It was pleasing to see reference to the following: stock control technology as an example of technical economies of scale; specialist buyers as a managerial economy of scale; and national advertising as a marketing economy of scale. Evaluation was generally better with consideration of standard diseconomies of scale, but also the importance of revenue, market share and firm objective as counter balance to the importance of lower unit costs. The best responses included supported judgements about the nature of the market and the relative importance of price and non-price competition for large retailers especially in the grocery retailing market.

### Misconception



Economies of scale relate to the reduction in long run average cost as the size of the firm increases.

Less successful candidates often express this as a reduction in total costs. This is not correct.

Larger firms have higher costs than smaller firms, but their unit costs are lower. This is an important distinction which centres are advised to teach candidates so they can engage in rigorous analysis.



## Exemplar 4

The importance of economies of scale would mean that firms are able to rescale, ~~to~~ increase the size of firms so they can expand. This would increase the amount of revenue and profits they would make because they would be bulk-buying. An increase in bulk-buying would mean average costs would decrease for every unit. Therefore, a producer would be able to sell these goods at lower prices, making more return in the long-run.

This response was given marks for reasonable analysis.

The response starts with an explanation of the importance of economies of scale in terms of revenue, which does not show an understanding of the concept. Nevertheless, it then goes on to reference bulk-buying as a potential economy of scale. However, there is no explanation of how bulk-buying reduces average cost, but there is a recognition that this will help the firm to charge lower prices. The response is not in context as there is no reference to large retailers or to grocery retailing mentioned in the stem to the question.

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